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Shift from Government Regulation to Government Control of Business

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Organized in 1925 to promote the study
of business enterprise
from an historical point of view

The Society collects business manuscripts, books, and reports, distributes publications, and otherwise promotes research; the Harvard Graduate School of Business Administration furnishes space and also assistance from the members of its faculty and staff. The Harvard Business School Associates receive all the publications of the Society.

BULLETIN OF THE BUSINESS HISTORICAL SOCIETY, INC.

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Editor's Introduction

This issue of the BULLETIN is made up of the papers read at the general meeting of the Business Historical Society, Inc., on April 11, 1946.[1] A word of explanation will indicate the thought which led to the selection of "Shift from Government Regulation to Government Control" as the subject for the program.

History is, to be sure, concerned with the past. The business historian delves into even the remote past because his object is to study the evolution of business from its beginning, and he follows business through the centuries of experience which have gone into the making of business today. The focus of the work of the Business Historical Society has in a real sense been distinctly on the present. Its publications have been based on the belief that to us today the value of the study of business history lies in the light it can throw on the present and the future.

We are living in a time in which business is undergoing a great change in its relations with government, perhaps a radical change. What is the nature of that change, and what is its significance? The historian can approach this subject from two points of view, that of long-time historical experience and that of recent developments. The former approach lends perspective, while the latter is absolutely essential to an understanding of the situation as it is at this time. Both points of view are represented in these papers. The combination of the two seemed to be feasible at the hands of members of the Faculty of the Harvard Graduate School of Business Administration who are interested in both.

The intention was not that these papers should in any sense be definitive. They were meant to state the problems and the issues and in a measure contribute to their clarification but with no thought of giving final answers. Professor Gras introduced the subject by reviewing the nature of regulation and control of business from the distant past to recent times. Then followed the three papers which dealt mainly with recent developments: the first, a broad consideration of those developments with special reference to production in war and peace, the second dealing with finance, and the third with public utilities.

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[1] Held at the Baker Library, Harvard Graduate School of Business Administration.

Historical Background

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When we read about "government control" in recent years and then reflect upon the old term "government regulation," we wonder whether a change has occurred. We ask our friends and find that they feel that there is a difference between the old regulation and the new control, but they hesitate to state what the difference is. Then we sit down to wrestle with the problem. The exercise is not easy. Perhaps the historical approach will be helpful.

Probably the most widespread and persistent government regulations have been in the interest of the consumer of necessities. The assize of bread and ale was in force from the twelfth to the early twentieth century. It fixed the price of bread and ale in terms of the market price of grain. Although one persistent effect was to limit the profits of the bakers and the brewers, the object was to provide the consumers with as low-priced necessities as the conditions of the market permitted. There were also laws against the adulteration of wine, spices, tea, and coffee, somewhat like our recent pure food laws. There were also laws prohibiting the unfair use of weights and measures. Persisting throughout the ages, such regulations have met the simple necessities of the consuming public. To be sure, they were indifferently enforced but they were not forgotten for long. We may accept these regulations as rules of conduct in the preparation and sale of goods.

The greatest experience of governments with regulation is to be considered under the head of mercantilism. This was a body of rules formulated in answer to a feeling that the citizen should have advantages over non-citizens abroad, that the body politic should be made strong during peace so as to insure success in war, and that the largest measure of self-sufficiency should prevail. It was found in mediaeval towns, early modern territories or provinces, modern nations, and, of course, the great empires of recent times. Indeed, during the period from the thirteenth to the early nineteenth century mercantilist regulations were the

order of the day. They were the means adopted to bring about material strength for the survival and well-being of the political unit, whether town, province, national state, or empire. The mercantile system or policy is too well known to justify our dwelling at length upon it.

Colbertism was a special form of mercantilism which deserves at least passing mention. The great French financier of the seventeenth century undertook to make France strong along many lines —finance, manufacture, foreign and domestic trade, shipping, and colonies. One of his distinctive efforts was to revive the old mediaeval town mercantilism promulgated by the craft gilds and accepted by the towns. According to the new formulation, the old dying practices of prescribing the quality and quantity of goods manufactured were not only revived but put on a national basis, just at the time when France in its effort to expand its trade abroad needed flexibility in production for a distant market.

In the century following Colbert, America reacted against British mercantilism not only by smuggling but by revolution. In this reaction, its own national spirit and organization took form. The mercantile regulations had restricted both exports and imports in the colonies and prevented the rise of colonial manufactures and banks. True, the regulations were not continuously enforced nor were they aimed particularly at American colonies. And, of course, there was no intention of benefiting any one British class, though the British merchants and manufacturers did stand to gain: the aim was to promote the interest of the Mother Country as against the colonies.

For reasons which we do not need to consider the whole mercantile policy gave way to a government policy of economic liberalism or *laissez-faire*. This is the policy that is opposed to government interference in the life of the citizen whether in business or not. It prevailed roughly during the period 1790-1890. It witnessed the halcyon days of the modern world—the glory of the despised Victorian Era. Men were freer from regulation than before or since. To be sure, there were laws, police, and courts to protect private property and private persons. Laws were designed to prevent unfair dealings between men, but on the whole there was great freedom from regulation.

Perhaps at this point we may try to uncover the essentials of government regulation or even to define it. Certainly there must be an intelligent opinion (held by the few or the many) which leads to legislation that is to be enforced by police and informers

and adjudicated by the courts. This adjudication may require months or years, during which time all parties are left uncertain as to what the law really means. And, in practice, there are found to be many loopholes in the laws and many opportunities for infraction and chiseling. Over the years, there is a slackening of interest for long stretches of time and a laxity of effort in making the laws effective.

At this point we may turn sharply to government control. About this elusive new system we may perhaps make the following points. Typically, government control is effected by a rule-making commission, a bureau which can fill in the gaps of the law. In effect, this means that the political administrators in the I.C.C., F.T.C., S.E.C., and so on "usurp" the power of the judges in formulating new laws or in declaring the intent of the legislators or even the conscience and will of the people. In order to prevent injury to some individual or groups the commissions may order business men to cease this practice and desist in that course of action; in other words, establish new procedures and formulate new policies for business. At times, the enforcement may involve the creation and use of a yardstick. The T.V.A. illustrates this. Some of the agricultural credit institutions also exemplify this point. And, lastly, this government control is apparently copied from business, though control did not itself originate in business. To the rise of control in business and borrowing by government we must give special attention.

It would seem that social control of a coercive character, of which government control is now the outstanding example, originated in the days before there was any regular business or indeed any specialized business men. Slavery appears to be the earliest example. Here control was maintained by direct oversight, organization, and records, aided by the social customs or political laws of the people in question. Which group—the slave or the master—benefited the more, we do not need to stop to consider.

After slavery came serfdom, which displayed degrees of freedom but which held men bound to the soil. The serfs were not only unable to move freely from community to community but they might not give their children freely in marriage to whomsoever they wished. The control by the lord was exercised by means of officials and accounting records. Indeed, the serfs or unfree tenants were themselves part of the control mechanism in so far as they willingly participated in the work and management of the lord's manor and of his courts. At bottom, serfdom was a

combination of unfree personal status and an unfree tenure of land. It was fundamentally the control of a group of lords over a group of tenants. That the obligations were reciprocal is true but this situation need not be stressed here.

Control in *business* was born almost at the start of business. When economic towns were created by the efforts of petty capitalists, that is, storekeepers and shopkeepers, there was devised a threefold system of apprentices, journeymen, and masters. Custom became embodied in the rules of the craft, even of the craft gild. These rules came to be enforced in the town's courts. The apprentices entered the house of the master for from 3 to 5 to 7 years, helped the mistress in household duties and learned the master's trade in shop or store, guarding his property and keeping his secrets. When the apprentice's time was up, he was graduated to the class of journeyman and given a suit of clothes or some implements of his trade and perhaps a small sum of money. At this point, the former apprentice could hire himself out by the day (*toute la journée*). The time of these journeymen was controlled by their masters under the rules of the craft. This was a system of control as real as that of slavery and serfdom; but the control was not a matter of status so much as of contract, for each apprentice or journeyman contracted to enter the system of control either by a formal document or in accordance with the normal practices of his trade.

When petty capitalism gave way to mercantile capitalism about the fourteenth century, a new kind of control entered the business world. The mercantile capitalist, otherwise called sedentary merchant, was a master in the art of using other men. Remaining in his counting house, he had ships and agents on many seas. His ship captains, his supercargoes, and his factors in foreign ports did his bidding. His problem was not only to sell goods but to procure commodities which he knew he could sell. Not a manufacturer himself, he had to rely upon small industrial masters for cloth, shoes, saddles, pewterware, iron utensils, and the like. These commodities he could purchase in towns, but he often preferred to go to the country villages where small masters had less expense and indeed where manufacture was commonly combined with agriculture. In the villages he could find cheaper wares and could exert more pressure to manufacture goods as he wanted them—goods of such quality, in such quantities, and at such times as suited his markets. It is a long story, occupying the period about 1300-1900, but the gist of it is that many mer-

chants reached out to control the small masters in towns and particularly in villages for the advantages indicated. How much of the control was owing to the merchant's reaching out for power and low-priced goods and how much was owing to the small master's inability to manage his own affairs cannot now be clearly expressed, nor are we called upon to do so. Nor do we know how much America was colonized by small masters trying to escape from the control of merchants. It is enough to know that the control was developed through the loaning of money to the small masters and the putting out of material for them to work on. All this was done through industrial agents and accounted for in special ledgers kept by the merchant.

When mercantile capitalism gave way to industrial capitalism, gradually during the eighteenth and nineteenth centuries, a new kind of control entered the pages of business history. This was control in central workshops, factories, and the like. Here, in large establishments, many workers could be put at jobs under the eyes of the industrial capitalist, his mill agent, and his foreman. Here a certain measure of the division of labor could be set up. But the main point is that the worker, hitherto laboring in his country home or town shop, could now be controlled in central establishments. By means of an organization of officials and by means of accounts the new control could be worked out. It is interesting to note that this control in industrial capitalism was being worked out at the very time that mercantilism was giving way to economic liberalism. Thus we see that government regulation and business control were going in the opposite directions.

By about the 1890's the new industrial capitalists were getting into financial difficulties: they were over-competing inside the framework of governmental liberalism. Factory was wrecking factory, railroad was outdoing railroad, and one steamship line was bankrupting its nearest rival. All this redounded to the disadvantage of investing capitalists, though often to the temporary advantage of consumers. In the interest of their clients, investment bankers and stockbrokers undertook to change this condition. They introduced control over the distressed industrial capitalists in the interest of dividends on stocks and interest on loans. The bankers and their friends formed voting trust arrangements, appointed presidents of failing companies, and installed more able directors. There is no thought that the bankers *aimed* at a new business *régime,* though in fact they established one of

brief duration—financial capitalism, the money power, or Wall Street dominance. Though the new *régime* had much merit and saved some concerns that now are the pride of America, still the bankers made serious mistakes. Although they used their control primarily to restore business concerns to sound conditions, still they did help themselves, as was to be expected, in the matter of security issues: it is a plausible conclusion, as it was a frequent charge, that the bankers issued stocks and bonds to profit from the fees and speculations involved. But with all this, we are not here much concerned. It is enough to notice that although many railroads and factories were put on a sound financial basis, still the public resented the existence of a money power (or "Money Trust") in its midst, a group of men who were said to be anxious to keep prices up and wages low and who were said to fatten on the farmer's misfortunes.

Politicians, ever looking for votes, found that they could get a hearing if they would denounce Wall Street, the Money Trust, or the Malefactors of Great Wealth. Theodore Roosevelt, Woodrow Wilson, and Franklin D. Roosevelt all joined the hue and cry. Following the Pujo Investigation of 1912, restrictive laws were passed. And under the guidance of the New Dealers, America was led right over into a new system of national capitalism, first cousin of fascism and naziism. The birth date is 1933.

Although the new system of government control grew fast after the depression of 1929-33, still it had deep roots in the earlier period. We should not forget the early State commissions, particularly designed to regulate railroads, the I.C.C. of 1887, the Federal Reserve System of 1913, and the Federal Trade Commission of 1914. But the alphabet soup was brewed chiefly in the period beginning in 1933. Just now (1946) we are confronted with a new commission to have charge of fair employment of races and colors, which to many threatens to be the last word in the government control of business.

I do not think that we have proven that government control was based on the model of business control, though I believe that the influence was there. Certainly the government was forced to make rules and issue orders to cease and desist. The investment bankers had been controlling financially weak industrial capitalists, as we have seen, and the world was studying and commenting on their methods and results. It was an easy step to overthrow the bankers and adopt their general plan of effective control. Henceforth, the boards of directors of private business

found that a central board of directors, in other words a commission, was formulating policies and procedures which limited their action. There were still problems of policy-formulation and management control left to the private boards of directors; but the field of action of the private boards of directors was being restricted by the national boards of directors. Political administrators were taking the place of business administrators, but only in part. The new system is national capitalism, not state socialism.

The times were ripe for the change. Social economists and social revolutionists had been urging changes in favor of the workers and consumers. The *first* World War had necessitated the control of transportation on land and sea as well as of speculation and investment; and before the War had ended there were plans to control the manufacture of goods. The *second* World War brought forth an all-out effort of both people and government. Credit, prices, and rents were controlled and production of many commodities was tightly controlled. All this was in addition to the established controls in transportation, communication, employment, and the issue of securities.

I do not suggest that the two World Wars did much except accentuate and accelerate government control. But these two experiences in international struggle have left deep impressions as well as deep scars in our politico-economic system.

It is fitting that we note, though we cannot dwell upon, the correlation of the incoming government control and the over-all social change involved. In all probability, there are two fundamental situations. One is the willingness of business men, the middle class generally, and the rank and file of American workers to experiment with government control in order to postpone, or even avoid, nationalization and socialism. The other is the belief that government control is a necessary and desirable step in the direction of extended or complete socialization sometime in the future. We may not like government control but we should at least understand its significance.

Government Controls in War and Peace

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The nation is just emerging from a state of wartime economic mobilization involving a degree of regimentation of its business life without precedent in this country and hardly surpassed by

the most dictatorial régimes abroad. At the peak of the war effort a typical manufacturer was largely directed by the government as to what he might make, what raw materials he might use, to which customers he might sell, in what order, and at what price. He could not enlarge or substantially alter his plant without governmental authority. He was limited in both directions as to the wages he might pay. While not subject to direct coercive control in the selection of manpower, he could generally not hire workers beyond a semi-compulsory employment "ceiling," and his manpower pool was radically limited by the demands of selective service and of competing war activities. His most important trade journal had become the Federal Register. While his discretion was not completely circumscribed, he moved within a framework so confined as to be tolerable only when the national existence was at stake.

This massive complex of direct wartime government controls was composed almost entirely of administrative regulations based on exceedingly broad grants of legislative authority. The actions of the War Production Board, for example—involving at their peak 23,000 employees administering over 700 orders and regulations—flowed from a few brief sentences in the Second War Powers Act authorizing the President to grant priority to military, lend lease, and essential indirect military orders, and to allocate scarce material or facilities "in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate in the public interest and to promote the national defense." In the field of price control, the administrators have been governed by somewhat more detailed legislative standards, but, by contrast, the system of wartime manpower controls was constructed with almost no legislative foundation at all.

While the great bulk of these wartime controls was swept away shortly after V-J Day, certain of them, particularly in the field of price control, are necessarily being retained in the difficult postwar transition through which we are now passing. It is easy to forget the extent to which controls have already been removed and to exaggerate the extent of continuing regimentation. But it is also clear that the current relation between government and business is far removed, indeed, from the conditions of the free market. Few business men are as yet free from price control. Many must still keep a watchful weather eye on continuing allocation and priority rules governing such scarce materials as cotton textiles, lead, tin, rubber, and lumber. Only last month a

drastic control over deferrable and nonessential construction was reinstituted in order to channel materials and facilities into low-cost housing for returning veterans. Moreover, apart from these formal governmental restrictions, the wartime distortions of the economy have left us with a legacy of pervasive material and equipment shortages, accentuated by the recent strikes; these shortages create an extreme sellers' market in most commodities and greatly complicate business operations in purchasing raw materials, machinery, and parts. Many business men now look back to the latter days of the New Deal as if to a golden era of *laissez-faire*. Some must wonder whether the war may not have left a permanent legacy of new direct governmental controls.

So far as the direct transfer of wartime control techniques to long-run peacetime use is concerned, I believe the answer to this question, for reasons I shall indicate later, is clearly "No." This is not to contest the fact that the war has modified the structure of the American economy in many ways. It has created some wholly new industries, such as synthetic rubber, and it has vastly expanded industrial capacity in others, such as the light metals, aircraft, and shipbuilding. The place of American business in the world's economy must be reviewed in a wholly new perspective. But the effects on government and business relations are more subtle than any direct peacetime adaptation of war controls.

Let us examine for a moment the historical trends in the economic activities of government. While on the whole they have shown an almost continuous, though irregular, expansion, this expansion has been less directly induced by war than might be supposed on superficial analysis. One is sometimes misled on this point by regarding solely the effects of war on the levels of total government expenditures and on the size of the public debt. The Civil War and the first World War each created a fivefold increase in the total peacetime expenditure level, and the recent war has probably resulted in a threefold increase. The public debt was increased by the Civil War from 65 million dollars to 2½ billion, by the first World War from 1¼ billion to 25 billion, and by the recent war from 40 billion to 275 billion. These mammoth increases in the public debt have important reactions on the entire credit structure of the country. Because of the heavy fiscal requirements for debt servicing they create difficult problems of public finance. But apart from their financial effects, our major wars appear to have played a quite secondary rôle in the expansion of the sphere of government. Thus in the period between 1850

and 1880 the number of federal civil employees increased only from 1.4 to 1.7 per thousand of the population. From 1880 to 1911, on the other hand, a period not marked by a major war, the numbers increased from 1.7 to 4.2 per thousand. Between 1911 and 1927 the increase was only from 4.2 to 4.5 per thousand, whereas in the peacetime years between 1927 and 1940 there was an increase from 4.5 to 8.5 per thousand. Similar results are found by examining federal expenditures exclusive of transfer payments (i.e., public debt service, pensions, and Social Security payments) in relation to the total volume of national economic activity. We can only conclude that the dominant influences motivating the expansion of government activities are not to be found in the short-run effects of war. They must rather be sought in such factors as the increasing industrialization of the American economy, the growth in political influence of organized agricultural and labor groups, and—of greatest contemporary significance—the fixing of responsibility on government for action to eliminate or mitigate the effects of cyclical economic depressions and large-scale unemployment.

Looking toward the future, we must probably expect some increase in government activities in advance preparation for the possibility of war. Until recently, the geographical isolation of the United States has permitted us almost complete freedom from peacetime government controls designed to protect the nation's security or to prepare for rapid industrial mobilization. We were notoriously unprepared for either of the two great wars of this century. Only the greatest good fortune in both cases gave us time to bring our industrial resources decisively to bear on the outcome. The nations of Europe have not been able to afford such a luxurious disregard of industrial preparedness. The extent of government economic activity abroad has been decisively influenced by this consideration, notably in the almost universal public ownership of basic industries such as the railroads, the electrical utilities, the air transport systems, and the radio. It is clear that in the unhappy event of another war, the United States would not again be granted the good fortune of two or three years' time for leisurely industrial mobilization. Until the international organization of security is far more advanced than at present, we must consequently expect our government to be actively concerned with such matters as the stock-piling of strategic materials not produced in this country, the maintenance of

stand-by industries, such as synthetic rubber, explosives, military aircraft, and, above all, the development of atomic energy. These inescapable necessities will create new points of contact between government and business and will involve controls affecting business decisions at many points not yet clearly foreseeable.

Moreover, apart from the effects of readiness for another national emergency, we clearly have in prospect a far closer relation between government and business than we have customarily envisaged in this country. This prospect arises from two sources. The first lies in the increasing numbers of occasions and pressures leading to government intervention at specific points in the economy. The second is inherent in the newly assumed interest of government in the level of economic activity as a whole.

Until the creation of the Federal Reserve System in 1913, and for the most part until the period of the New Deal, governmental intervention in economic life was generally designed either to create a workable framework for business enterprise (provided through the enforcement of contracts, the patent system, the rules of bankruptcy, the generous disposal of the public domain, and the like) or to remedy specific abuses appearing to arise from undue concentration of private economic power (such as railroad regulation, utility regulation, and the antitrust laws). There is no reason to suppose that this category of government intervention will not continue to expand. Private limitations on free competitive markets are not contracting. Indeed, the technical and social developments of this century are apparently expanding the area of such specific types of government intervention.

In the field of radio communication, for example, the limited number of available wave lengths has forced government to regard the air as a public trust and has compelled some degree of public regulation to prevent its abuse. The same is true of commercial air transport. The enormous increase in the size and power of labor unions has threatened to create new types of monopolistic restrictions which call, in turn, for a degree of public regulation. Observing the shattering effects on community life of strikes among the New York tugboat workers, the transit and utility services of other cities, and basic national industries such as coal and steel, we cannot but wonder whether the community can afford private industrial warfare which threatens the safety and welfare of so many innocent bystanders without intervening in some manner through its organized public representatives.

Moreover, we have seen in industries like bituminous coal, cotton textiles, and much of southern agriculture, during the 1920's and 1930's, some of the evil effects of excessive competition, and people have turned to government to soften their rigors. And while many of these controls appear chafing to the business man, others are instituted at his own behest and may, indeed, be essential to the proper functioning of private enterprise.

Superimposed on all these manifold types of government intervention in particular cases, the Great Depression called forth new responsibilities on the part of government for the over-all economic well-being of the nation. This responsibility was accepted in fact, although reluctantly, by President Hoover's administration; it was carried on more willingly by President Roosevelt; and it is now a cardinal element in the official programs of both political parties. During the debates on the recently passed Employment Act of 1946, there was a great deal of discussion over the precise terms in which to express this responsibility. Most of these intense verbal quarrels were misplaced. The primary issue was not the existence of government responsibility for avoiding or relieving mass unemployment. Regardless of the statute books, it has been made abundantly clear that the people will look to government for action if such unemployment recurs. The real debate was over the proper means of discharging the responsibility—a point on which there is need for much more extensive and constructive debate before decisions are reached. But however it is discharged, the effect of this newly recognized responsibility must likewise be a further extension of government economic activity, at least of a contingent variety. Whatever the merits of the budget-balancing versus the deficit-financing schools, or the consumption-promoting versus the investment-promoting schools, it is increasingly agreed that decisions on government revenue and expenditures must be made with an eye toward their effects on general national production and employment. In short, it appears that we must have a fiscal *policy*. This is something new under the sun.

In summary, then, we are in fact in a "mixed economy" whether we like it or not. It is equally naïve to condemn all government controls as evil and to assume that all government action, merely because it is government action, is beneficent. There is no diminution in the basic faith of Americans in private enterprise as the mainspring of our economic life or as the desirable means for carrying on economic activities. At the moment,

indeed, it is all too difficult to recruit competent men to serve government. But there is a notable diminution in the faith that the free interplay of unrestrained private enterprise will automatically serve the public welfare. Private enterprise is therefore expected to adjust itself to an increasingly complex framework of governmental controls. Under these conditions, the important practical questions are questions of degree: How much government control? What kind of government control? What kind of balance between general fiscal measures and specific regulatory measures? Government control conducted by what kind of people? And what kind of working government and business relations? On some of these questions, our wartime experience can shed real light.

The basic problem is to find a working relationship between government and business in which government can discharge effectively the responsibilities imposed upon it by the people without sacrificing the inherent virtues of private enterprise. If private enterprise loses its incentive for innovation, for expansion, for initiative in finding new markets, new economies, improved techniques of production and distribution, then the economic structure is destroyed at its foundation. If government employees are corrupt, if they respond to particular pressures putting "heat" on them to the detriment of the broader policies imposed by the democratic general will, the process of control will degenerate into traffiicking in favors and privilege. To achieve the desired result while avoiding these twin evils is a high challenge to government, to the business world, and to the nation at large.

The working instrument through which government must play its part under modern conditions is the executive. We are faced with big government, and, while perhaps regrettably, big government is inherently executive government. Here too, the living issues are not the restoration of legislative and judicial supremacy in the sense of abandoning administrative regulation in favor of detailed legislative mandates or in relying exclusively on the judicial process. Both Congress and the courts are already so bogged down with problems of administrative minutiæ as to threaten their basic functions of setting the broad framework of policy and of holding administration to the standards of the rule of law. The need is rather to accept the inevitable fact of bureaucracy, but to devise means for making the bureaucrats effectively responsible to the legislative will and to safeguard the vital judicial function of preventing discrimination in individual cases. This

problem, too, calls for new perspectives in analyzing the respective functions of legislature, executive, and judiciary, and in responsibly organizing the executive arm.

I have said above that the wartime experience in production, distribution, price, investment, and manpower controls has little direct relevance for the peacetime relation between government and business. Such controls are compelled by the universality of shortages in a wartime economy. These shortages derive in turn from the tremendous muscular effort of simultaneous economic expansion and conversion from civilian to military production. The normal processes of economic adjustment could not induce economic mobilization quickly enough, and, in fact, could never induce total economic mobilization, regardless of the time at our disposal. But universal shortages will not persist beyond the immediate postwar transition. Many shortages have already disappeared. Only under conditions of continuous wage and price inflation would such controls be theoretically indicated in peacetime, and even then they could hardly be practically administered. Direct controls of this type are complex beyond the capacity of the imagination to conceive. They involve judgments as to relative essentiality which were acutely painful in wartime and which no sane human being would undertake in peace. Moreover, they tend to freeze the status quo, since that is the only firm basis on which to make decisions. They invade areas of business judgment which lie at the heart of private enterprise. Whatever the degree of good will in their administration, whatever the expressed intent and actual desire to avoid discrimination and to provide for innovation, they are inevitably replete with inequities and arbitrary judgments. Their coercive character can gain general acceptance only under the spur of national emergency.

What, then, are the constructive lessons of the wartime control experience? They are to be found beneath the surface, rather than in the direct transfer of wartime controls to peacetime use. For the most part, they require intensive analysis, but a few stand out even on casual reflection. One is the clear superiority of what we may call "inducive," as contrasted with coercive, measures for accomplishing many of the objectives of public policy. A notable prewar example is the system of production control established under the Agricultural Adjustment Acts of 1933 and 1938. A contemporary instance is the Veterans' Emergency Housing Program. This program, to be sure, relies partly on the wartime type of direct control over deferrable construction and the flow

of building materials. But its primary reliance is on providing incentives and facilitating the play of private enterprise in providing both conventional and prefabricated low-cost housing on an unprecedented scale. The advantages of such controls are obvious. The private individual may choose for himself whether or not to join the program and to what extent he wishes to avail himself of government aid. Problems of possible discrimination and the avoidance of individual hardship are minimized, greatly simplifying the task of the administrator. Such measures are far less likely to enter the area of diminishing returns in which the burdens of equitable administration and the costs of effective enforcement outweigh the benefits of the control. There are, of course, also dangers in this approach—particularly the danger of encouraging a succession of organized pressure groups to seek milk and honey from the public trough. But such dangers are not insuperable.

A second constructive lesson of the wartime control experience is the development of systematic techniques for enlisting the participation of the regulated in the process of regulation. The advisory committee structures of the War Production Board and the Office of Price Administration, and the Management-Labor Committee structure of the War Manpower Commission, carried this principle to new heights. Such participation is not to be confused with "self-regulation" as practised under the National Recovery Administration, where trade associations were, for all practical purposes, invested with public sovereignty without adequate public accountability. An effective advisory committee system permits the technical knowledge and competence of the regulated to be fully utilized and draws on the inventive capacity of the regulated, while preserving strictly the clear channels of public responsibility.

Closely related to this point is the increased mutual understanding—and in many cases increased mutual respect and tolerance—between professional government servants and business men. The employment by the government of thousands of business men during the war and the innumerable and intimate daily contacts between professional administrators and operating businesses provided a unique opportunity for the growth of such understanding. The experience suggests the possibility of improved government personnel practices, with provision for systematic interchange of qualified persons between government and private jobs. In any event, it is evident that the broader responsibility of government can be discharged only if the public service can

obtain men fully trained in an understanding of business operations and viewpoints as well as of the requirements of public policy.

Finally, and perhaps most important, the wartime experience brought home to large segments of the business community an understanding of the increased integration of the modern community and of the public responsibilities imposed by their unique position of leadership in the American economy. This viewpoint is evident in the attitudes of the Committee for Economic Development and is widely reflected in other quarters. In the case of the larger enterprises at least, it is clear that the making of business decisions solely in terms of the short-run profit-and-loss account of the company is neither sound business nor sound citizenship.

As we review the development of business and government relations over the decades, and compare American experience with that abroad, it seems clear that no firm line of demarcation can be drawn and held between the respective activities and responsibilities of government and business. That line has always been fluid. In a dynamic society it must always remain fluid. There can be set off at either extreme certain areas which government must occupy to satisfy the minimum requirements of public policy and others which it cannot invade without destroying the mainsprings of private enterprise. Between these two areas is a very wide zone indeed. In this zone, our attention should be focused on the detailed nature of the government-business relationship and on devising means for making this relationship reciprocally fruitful rather than sterile. In a search for these means, the careful analysis of our wartime experience in government control has much to offer.

Governmental Activity in the Financial Field

Charles Cortez Abbott

Associate Professor of Business Economics

Professor Gras has asked me to talk today on government regulation in the field of Finance. When he first mentioned the matter it seemed to me a most stimulating suggestion. The more I considered it, however, the more difficult the assignment ap-

peared. The more I thought about it the more the subject seemed to be made up of a large number of topics relatively unrelated to each other. Management of insurance companies can hardly be treated in the same paragraph with the divorce of security affiliates from commercial banks, and competitive bidding has little in common with measures designed to protect bank depositors. While many of the particular segments of this subject possess great interest in their own right and deserve careful individual treatment, they are for the most part technical and cannot be dealt with adequately in the time at my disposal. Moreover, they are in many instances special subjects. By this I mean that they have wholly different backgrounds, that their internal logics are dissimilar, and that the kinds of knowledge needed to see each in its proper perspective are quite disassociated. The problem is to knit this compartmentalized subject together so as, on the one hand, to see it as a whole, and on the other hand, to avoid somewhat empty generalities.

I am sorry that I cannot present a single body of closely integrated doctrine. The most I can do is to offer a number of suggestions for your appraisal. My hope is that these may form the basis for further thinking that will lead to more positive results.

As I turned over in my mind what I might say today it seemed to me, although the subject had numerous facets about which it was not easy to generalize, that many governmental actions of a regulatory nature could be classified into certain categories. One type of governmental action relatively easily recognized is that designed to give, or which does in fact grant, special protection to particular groups of persons. By way of illustration I may mention beneficiaries of trust funds, bank depositors, policy holders of insurance companies, and purchasers of securities. Very often, though not exclusively, this type of action has had a legislative rather than merely an executive origin.

As regards some of these groups, society's efforts at protection have a long history. In other cases, public policies are of a more recent origin. The type and extent of protection of course differs markedly in particular instances. These various situations are similar, however, in that the government—generally for what we would all consider good and sufficient reasons—has singled out particular financial relationships which the law will scrutinize with special care. In some instances, though I doubt if in all, the origin of this protection is an attempt to correct a

practice deemed an abuse. In any event, the result has been the formation of what I have termed protected groups, groups of people who — as regards carefully stipulated legal, financial, and commercial transactions—are safeguarded to a degree not characteristic of many of their other relationships in society.

In general the effort to furnish this form of security has sought to accomplish its purpose by establishing standards of one sort or another. Sometimes they have been standards of conduct. Sometimes, as in the case of security purchases, they have related to the disclosure of pertinent information. The legal limitations placed on the maximum size of loans that a commercial bank may make, which relate the size of the loan to the magnitude of the bank's capital funds, are of this general character, as are the various kinds of restrictions placed on the types of investment that may be made by commercial banks, savings banks, and insurance companies.

Efforts of this sort, directed at giving special protection and security, have been undertaken at both the State and federal levels. Typically the pertinent statutes and administrative rulings have been technical. Perhaps this is simply another way of saying that they have been carefully shaped to accommodate the business characteristics of the institutions to which they applied, and that they have been formed—at least in part—by technicians familiar, as the case may be, with the actual operating details of the securities business, the insurance business, or the banking business.

Very commonly these attempts to protect people in certain of their financial relationships have been reasonably successful, at least in terms of their immediate goal. Whether they have been as successful when viewed in wider terms is more doubtful.

At the present time it is fashionable to assess the effects of public measures with reference to their effect on the welfare of "the whole economy," to appraise the contribution they make toward the achievement of some goal such as "stabilization of the business cycle" or "maintenance of full employment." Here these measures have, perhaps, a less favorable record.

Let me cite one example to illustrate my point. The rulings of the Comptroller of the Currency in 1936 and 1938 which defined investment securities purchasable by banks in terms of the ratings given by the private rating services no doubt improved, as was intended, the quality of the investment portfolios of commercial banks. On the other hand, a good deal of evidence exists which

suggests that as a result of these rulings small local companies, whose bond issues were too small to merit a rating from the rating services, were no longer able to sell their bonds to local banks, and consequently lost an important part of their ability to raise capital cheaply and easily.

Another sort of governmental regulation, perhaps related to though I believe distinguishable from the first type, is actions designed to correct specific financial practices currently considered by public authority to be abuses. Here may be mentioned such matters as the divorce of security affiliates from the commercial banks compelled by the Banking Act of 1933, the Public Utility Holding Company Act of 1935, and the rules of the Interstate Commerce Commission and the Securities and Exchange Commission that require publicly offered security issues to be sold through public competitive bidding rather than through private negotiation.

Governmental regulations of this type, like those of the type first mentioned, are limitations upon managerial discretion. They narrow the orbit within which business managers operate and reduce the number of alternatives open to the executive. At one time this aspect of governmental controls, the reduction of choice and of discretion which they commonly impose upon management, seemed to me one of the most fundamental aspects of governmental regulation, one of the generalizations that it was most important to make. More recently I have not been sure this was the whole story. This sort of appraisal does not, for instance, do justice to government undertakings designed to perform functions not fulfilled by private institutions. Certain of the services provided by the Federal Deposit Insurance Corporation, the Export-Import Bank, and the Reconstruction Finance Corporation illustrate this point. In passing we may note that in this particular area governmental policy in recent years has increasingly been given effect through a government corporation. Whether we fully understand all the economic and political implications inherent in this type of financial institution, and whether it has yet been satisfactorily merged into our governmental processes, seems to me doubtful.

One type of governmental activity in the financial area has of late years achieved increasing popularity and importance. I mean the action intended to influence in a broad way the general course of economic events. For example, the efforts of the Federal Reserve System during the 'twenties to maintain an orderly money

market and to control credit conditions possessed this nonspecific character. So also do many of the suggestions currently advanced for what economists call a "compensatory spending" policy. Various of the innovations in the financial field that have been initiated or are contemplated by the Labor party in England fall into this category. One characteristic, perhaps the leading characteristic, that manipulative actions of this type have in common is that they are intended to affect economic events in a positive, constructive way; they are not designed to exert only a repressive or prohibitory influence. In this respect they are, in some degree, qualitatively different from the two types of governmental action first mentioned. Perhaps one of the distinctions between what Professor Gras has called "regulation" and "control" is just this—the relative weights given, in a particular statute, to the negative and the positive, or to the repressive and the stimulative.

In my opinion, governmental activities directed at influencing the character of the framework within which private initiative and the investment process operate have been more uncertain in their result than have laws aimed at correcting a specific abuse or establishing some particular standard. Clearly, those Federal Reserve policies that sought between 1927 and 1929 to check the bull market of the New Era failed of many of their purposes. Little reason exists to believe that the devaluation of the dollar in 1933, undertaken at least in part to raise commodity prices, exerted any considerable effect, except in the case of items entering international trade. The prewar spending programs designed to stimulate or to produce economic recovery did not, except to a very limited extent, accomplish their objectives. Statements indicating that the federal government by varying its rate of expenditure can regulate the total volume of spending in the country and thus control the level of economic activity must be appraised in the light of instances in which the government was unable to control its expenditure. In 1937, for example, when President Roosevelt instructed all executive agencies to set up 10 per cent of their appropriations in a reserve fund, it was found that several agencies could not comply with this instruction and continue their operations.[1] And in the midst of a war, of course, no one supposes that spending can be guided by any principle except the successful prosecution of hostilities.

We must not, I believe, in thinking about governmental regula-

[1] See D. T. Selko, *The Federal Financial System*, Washington, D. C.: The Brookings Institution, 1940, p. 161.

tion or control in the financial field, overestimate what even the best-conceived and best-administered policy can achieve. Very real limitations on the power of government exist in fact, as well as in law. Let me illustrate briefly what I mean. Relatively little accommodation has ever been extended to business by the Reserve Banks through so-called "section 13b loans" compared with that extended by private institutions, and relatively little of what I would call straight business lending has ever been done by the Reconstruction Finance Corporation, notwithstanding the apparent intention of the government to supplement substantially the lending of private institutions. During the 'thirties the government was not able to induce individuals to make appreciable investments in business equities, notwithstanding the evident need of the economy for this type of action. Bank examination can and does accomplish many beneficial results, but as was pointed out in the Federal Reserve's "Banking Studies," it "cannot force an expansion of loans and investments." [2]

To my mind we have not squarely faced up to the fact that the governmental process cannot in every instance accomplish all that policy-makers or administrators in the executive branch desire. We have not studied sufficiently where the limits of effective governmental action lie. In appraising governmental regulation and control, and the spheres of action that properly pertain to government officials and to business men, I believe we must in the future pay much more attention to this aspect of the subject than we have in the past.

In conclusion, let me say that during the last fifteen years in this country changes have taken place in the financial world with a speed that, by comparison with other periods, seems much greater than can be regarded as normal. Moreover, numerous of these developments, many of which were initiated by governmental action, have been of the highest significance. Future business historians, I believe, will describe this period as one in which evolution in the field of finance was so swift and of such a momentous character as to be almost revolutionary. If I may glance at the future as well as at the past, I will venture a guess that this abnormally rapid process of change will continue for a number of years, and that it has as yet hardly reached the half-way mark in its course.

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[2] R. F. Leonard, "Supervision of the Commercial Banking System," *Banking Studies*, Board of Governors of the Federal Reserve System, 1941, p. 193.

Public Utilities

C. O. Ruggles

Professor of Public Utility Management and Regulation

The public utilities furnish numerous and outstanding examples of government regulation and later government control if we follow the distinction between these which Professor Gras has indicated. Aside from water, the oldest of our utilities are those furnishing artificial gas, beginning in Baltimore in 1816. The early franchises or charters granted to these utilities represent, according to Professor Gras' definition, extreme forms of government regulation, because these franchises or charters actually fixed rates and prescribed the character of service to be rendered for very long periods of time, say for fifty years or double that length of time. In the case of our earliest railroad charters, granted beginning about the middle 1820's, the power to make rates was often granted to the Boards of Directors of the companies. Some States, while permitting the rates to be made by the railroads themselves, did make reservation of such power to the State if need arose for exercising it.

Curiously enough in the case of both of our oldest utilities the public, along with regulation which fixed rates for long periods of time and prescribed the character of the service to be rendered without regard to possible advances in the arts, also insisted upon competition among companies. Even in rather small communities franchises were granted on the assumption that franchises would be granted to competing companies. A good example of this is seen in the case of Paterson, New Jersey, in 1858, when it had a population of approximately 19,000. In a case before the New Jersey Supreme Court involving the refusal of the gas company to serve a customer located on a street where the company actually had a gas main the court held that the franchise was permissive, not mandatory, and that it assumed there would be competition of gas utilities in Paterson. Indeed, the court pointed out that, if the company could be compelled to furnish the service demanded, it could be required to furnish service to all in Paterson. The court expressed surprise that any company "could have ventured to assume such a responsibility as that."[1] What eventu-

[1] 27 N. J. Law 245 (1858).

ally happened regarding competition of gas utilities in larger cities is indicated by the titles of the existing companies which contain the word "Consolidated."

The wider scope of railroad service obviously called for regulation first by States and later, as these utilities became interstate in character, by the Federal Government. No State regulation of any significance developed until the 1870's, about 100 years after the Declaration of Independence. Our first important federal regulation of rail carriers followed by more than a decade the regulation by the States. Professor Gordon's statement regarding the impact of war on regulation or control is borne out by our experience following the Civil War, so far as the railroads were concerned. Indeed, during the war men who voted for legislation giving Abraham Lincoln certain control over railroads during that war were very careful to explain their votes (before recording them) as being a sanction of military control and that they were opposed to any federal regulation of railroads in times of peace. After the close of that war there was little interest in Congress in the regulation of carriers. Curiously enough a resolution was introduced into the House of Representatives actually raising the strange question whether Congress had the power to regulate passenger fares and freight rates on interstate railroads, and if a committee found Congress to have such power it was directed to recommend such legislation. Again Congress' lack of interest in railroads is revealed in the fact that this resolution was referred to the Committee on Canals.

This committee did not see eye to eye in making its report. While the majority report stated that Congress did possess the power, the committee did not make any recommendation for such regulation. It gave as the reason for not doing so that it did not have adequate information upon which to base proposed legislation.[2] The minority report, which was much longer than that of the majority, was highly critical of any legislation which would enlarge the scope of federal power by authorizing the Federal Government "to enter a state and tamper with her corporations." Among other things the minority report said:

> A brief contemplation of the extent, wonderful growth, and vast expense of the railroads alone may afford some aid in an attempt to appreciate the infinite dangers which would result from committing them to the control of the central government. . . . The com-

[2] *Report No. 57*, 40th Congress, 2d Session, House of Representatives, Majority Report, pp. 1-8.

> merce and trade which are more or less facilitated by this extraordinary net-work of railroads, and the great multitude of persons who thus find compensatory employment, render our system of railroads a handmaid to every other pursuit known to our people. It pervades, influences, and promotes the welfare of every section, farm, and workshop in the republic. It has attained its present magnificent proportions with no guide but the unparalleled enterprise and intelligent self-interest of the people.

The minority felt keenly that whatever regulation of railroads might prove to be necessary should be provided by the States.[3]

In 1872 a Senate committee was appointed to consider the need for cheap transportation from the interior of the country to the seaboard markets for agricultural products. The "Select Committee on Transportation Routes to the Seaboard," of which Senator Windom of Minnesota was chairman, presented a voluminous report in 1874. The committee considered direct regulation, but it recommended, instead, certain yardstick railroads to be built, owned, and operated by the government or owned by the government and leased. These would make low rates and thus, through competition of such government roads, the privately owned and operated railroads would be forced to provide the "cheap" transportation that was considered so vital to the agricultural areas of the country. As a part of its "general summary of conclusions and recommendations" the committee said:[4]

> Though the existence of the Federal power to regulate commerce to the extent maintained in this report is believed to be essential to the maintenance of perfect equality among the States as to commercial rights; to the prevention of unjust and invidious distinctions which local jealousies or interests might be disposed to introduce; to the proper restraints of consolidated corporate power, and to the correction of many of its existing evils, yet your committee are unanimously of the opinion that the problem of *cheap* transportation is to be solved through *competition*, as hereinafter stated, rather than by direct congressional regulation of existing lines.

For the decade following the close of the Civil War the focal point of interest in the direct regulation of railroads was in the attempts of the States, not of the Federal Government. Interest of the States in such regulation began to appear as the high prices began to fall; this fall had been brought about in part by the issue of paper money during the war. Prices of grains also declined sharply during this period as the result of great concentration for

[3] *Ibid.*, Minority Report, pp. 8-20.

[4] U. S. Senate Document 1588, 43rd Congress, 1st Session, 1873-1874, Senate Reports, Vol. 3, Part 1, p. 242.

some years upon the cultivation of a few staple grain crops. This unbalanced agriculture had been greatly stimulated by the Homestead Act which encouraged many Civil War soldiers to engage in farming, especially in the great agricultural States with their wide expanse of fertile acres. Such great concentration on grain farming obviously did much to depress the prices that were of vital interest to those States whose farmers were most dependent upon low railroad rates to ship their products to the seaboard. It is not surprising, therefore, that our first attempts in State regulation are found in such States as Iowa, Illinois, and other midwestern States.

In 1866 a resolution was introduced into the Iowa legislature requesting the attorney general of that State to report to the legislature whether it had the power to regulate freight rates and passenger fares of the railroads in that State.[5] The attorney general reported among other things as follows:[6]

> . . . although railroad corporations have the right to take property for their use, under the power in the State to take private property for public use, still the corporations are private corporations, although the property taken is for a public use by such corporations. This power does not grow out of their rights as corporations, but is conferred upon them by express provision of law.
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> When the legislature of Iowa granted these railroad charters, through the general incorporation law, it permitted these corporations to receive pay for the carriage of both freight and passengers, leaving it to the laws of trade and competition, which extend over all civilized communities, to regulate the rates of such charges. Laws never have and never can regulate these matters effectually. There are no special privileges granted in this State. The field of competition is open to the world.
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> . . . .
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> In many of the charters in the Eastern States the right to regulate rates of fare, etc., was expressly reserved. In others the right to repeal, alter or modify the several charters, was also reserved.
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> . . . .
>
> The conclusion to which I have arrived is, that the General Assembly has no power to restrict and regulate the tariff of prices for passage and freight over the several railroads in this State, nor the tariff rates of Express Companies.

That Illinois had lost faith in competition as a means of railroad rate regulation is seen in the fact that the constitution of

[5] Iowa House Journal, 1866, p. 75.
[6] *Ibid*, pp. 124-129.

that State was amended in 1870 to provide for the regulation of the charges of grain elevators and of railroads. The landmark case of *Munn* v. *Illinois* was argued twice before the Supreme Court of Illinois. On the first argument the court after much deliberation was unable to reach an agreement. In the meantime two new members were elected, and in the words of the court "it was deemed expedient and proper" that these new members should take part in the decision; hence a reargument was ordered. The decision of the court upheld the law, but two judges dissented. The decision of the court held that the grain elevators and their close association with the railroads constituted a combination which had shut out all competition and that:[7]

> . . .'. The producer and shipper had no alternative but submission. They were completely in the power of this combination, and it did not fail to demand and exact the highest charges. It is this state of things the law is designed to remedy. One of the first and most imperative duties of the law making power is to enact all necessary laws to remedy existing evils, taking care, in so doing, not to transgress any constitutional limitation. The means by which to do it most effectually is, in the discretion of the legislature, keeping in view the provisions of the organic law.
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> That body could not withstand the appeals that went up to them from the producers and shippers of the great and indispensable wants of man, and forming the most valuable portion of our staple productions, to provide some remedy against the oppression and extortions to which they were subjected by this organized combination of monopolists, already such a formidable power, with but one heart, and that palpitating for excessive gains.
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> . . . .
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> There is no taking or damaging private property here, and devoting it to public use. It is an expression of the will of the people through their representatives in the General Assembly, that these seats of oppression and extortion should be brought into subjection, to the great relief of the people.

When this case reached the United States Supreme Court we have evidence that that Court believed the case raised vital issues which called for thorough consideration. After the Munn case had been argued before the Court it was 13 months before a decision was handed down. The Court stated that it had held the case for more than a year because of the importance of the issues involved, and because it wanted to take ample time to consider whether it should sanction such government regulation. It

[7] *Munn et al* v. *The People*, 69 Ill. 80, 94 (1873).

should be noted that the regulation was being applied to what we now recognize as full-fledged public utilities. But in spite of this fact, two justices dissented on the issue whether even industries affected with a public interest should be subjected to regulation.[8]

Once the Court had decided that the States had the right to regulate grain elevators and railroad rates, it took the position that, if such rates were believed to be unreasonable, the remedy lay not in an appeal to the Court but rather to the people themselves through the voting booth. The position of the Court on this issue is made clear by its statements in a number of cases involving railroad rates. In one case the Court said:[9]

> As to the claim that the courts must decide what is reasonable, and not the Legislature. This is not new to this case. It has been fully considered in Munn v. People of Illinois. Where property has been clothed with a public interest, the legislature may fix a limit to that which shall in law be reasonable for its use. This limit binds the courts as well as the people. If it has been improperly fixed, the Legislature, not the courts, must be appealed to for the change.

After holding this view for almost a decade, the Court began to shift its position. This was becoming clear from dicta in some of its decisions. In one such case where the power of the State to fix rates was upheld, it was said:[10]

> From what has thus been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretense of regulating fares and freights, the state cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law.

Finally in 1890 in the *Chicago, Milwaukee & St. Paul Railroad Company* v. *Minnesota,* the Court reversed itself in holding that it was the function of the Court, not the legislature, to determine the reasonableness of rates.[11] The Court was justified on economic and business grounds, leaving aside legal issues, in reversing its position in 1890 and taking the stand that it was the function of the courts rather than of the legislatures to de-

[8] *Munn* v. *People of Illinois,* 94 U.S. 113, 136 (1877).

[9] *Peik* v. *Chicago & Northwestern Ry. Co.,* 94 U.S. 164 (1877).

[10] *Stone* v. *Farmers' Loan & Trust Co.,* 116 U.S. 307, 6 S. Ct. 334, 345 (1886).

[11] 134 U.S. 418.

termine the reasonableness of rates. It seems strange that a legislature could have assumed that what Professor Gras has called regulation—that is, by a statute actually freezing railroad rates for two-year periods between the sessions of the legislature—would have been likely to result in reasonable rates from the point of view of either the carrier or the public. Surely there was no opportunity when the legislature was not in session to make any changes in rates, because at that time commission regulation was not in the picture. There was to be a long controversy over the right of a legislature to delegate its power to such administrative agencies. In the absence of commission control to make what the Supreme Court has recently called "pragmatic adjustments," it was necessary for the courts to step in to pass upon the reasonableness of rates to prevent great injustice either to the railroads or to the people.

It was during the deep depression of the 1890's that Nebraska passed railroad legislation that finally brought the notable *Smyth* v. *Ames* case before the Court. In this case the Court decided that the State had exceeded its authority in requiring railroads in that State to charge freight rates that did not, in the case of some of the railroads, yield enough revenue to cover even operating expenses, to say nothing of some sort of return upon some legally determined rate base. It was in this decision that the Court enumerated a number of factors, including original cost, reproduction cost, and other matters, which it said should be considered in finding a rate base.[12]

In the Hope Natural Gas case decided in 1944 the Court held that the commissions rather than the courts shall determine what elements are to be considered in finding a rate base and in determining the reasonableness of rates provided the "end result" is justified. Its action in 1944 was foreshadowed in 1942 in the Natural Gas Pipeline case. In that case the Court said:[13]

> The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been

[12] 169 U.S. 466.

[13] *Federal Power Commission et al* v. *Natural Gas Pipeline Co. of America et al.*, 315 U.S. 575, 586.

> overstepped. If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.

In the Hope case the Federal Circuit Court had reversed the Federal Power Commission because in finding a rate base that commission had not given consideration to the cost of reproduction of the utility. The Supreme Court reversed the Circuit Court and left to the discretion of the Federal Power Commission matters which in other cases, beginning with *Smyth* v. *Ames,* down to the Hope case had been determined by the Court. In other words, commissions are no longer required to take into consideration certain standards which the Court enumerated in the Smyth case and repeated in numerous cases down to the time of the Hope decision. Concretely, according to the Hope decision, the Court will not hereafter require the use of original cost, cost of reproduction, or other specific standards, but will permit commissions to follow their own methods of arriving at a rate base provided the "end result" is satisfactory. Among other things the Court said:[14]

> Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. . . . It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.

But the reversal in the Hope case of the position which the Court had held for almost half a century brought forth five opinions from eight justices. Mr. Justice Roberts took no part in the case. Mr. Justice Douglas delivered the majority opinion, which was supported in a concurring opinion by Justices Black and Murphy. Justices Reed, Frankfurter, and Jackson each presented a minority opinion. Moreover, in some natural gas cases decided in 1945, the sharp dissent of four justices in one case was focused upon the manner of calculating a rate base. The minority contended that the Federal Power Commission had disregarded the Natural Gas Act of 1938 in arriving at a rate base.[15] In view of the marked

[14] ***Federal Power Commission*** **v.** ***Hope Natural Gas Co.,*** **320 U.S. 591, 602.**

[15] ***Colorado Interstate Gas Co.*** **v.** ***Federal Power Commission and Canadian River Gas Co.*** **v.** ***Federal Power Commission,*** **324 U.S. 581, 615.**

differences of opinion in the Hope case and close division of the Court in another recent case, it is conceivable that a reversal of the Hope decision might occur.

These recent Supreme Court decisions, throwing back certain functions not upon the legislative bodies themselves but upon the public utility commissions created by Congress and the State legislatures, place a very great responsibility upon the public itself. The public should lose no time in calling upon the legislative branch of the government to bring about marked improvement of regulatory commissions, both federal and State. These administrative agencies have been given new and very great responsibilities by the Court's action. Unless these commissions are greatly improved, it may prove to have been unfortunate that the Supreme Court turned over to the commissions in 1944 the task of determining such matters as a rate base, reasonable rates, and what constitutes a fair rate of return. At the present time many of our commissions are not adequately prepared to perform such important functions. We have not yet appreciated in this country the vital need for well-equipped administrative commissions. When the writer made a study of State utilities commissions in 1937 the average annual salary of commissioners was but $5,000, and with one or two rare exceptions the salary of experts on commission staffs was less than that paid commissioners.[16] Nor were conditions of tenure either for commissioners or for members of the staff of the commissions such as to induce an adequate number of well-trained men to seek such posts. Political interference with the functioning of the commissions has not added to the attractiveness of a career in the work of such commissions. The utilities themselves, in opposing the financing in part at least of some of these commissions by some sort of a levy upon utility revenues, have to some extent been responsible for the existence of too many weak commissions. Events proved during the deep depression of the 1930's that tenure of office and the level of remuneration of commissioners and their expert staffs were much more satisfactory in the States where commissions were thus financed than in the States where commissions were wholly dependent upon State appropriations for the support of their regulatory work.

[16] *Aspects of the Organization, Functions and Financing of State Public Utilities Commissions*, Harvard University, Graduate School of Business Administration, Division of Research, Business Research Studies, No. 18, 1937, pp. 90.

Governors elected on pledges of strict economy slashed the budgets for the utilities commissions along with cuts in other State activities. The tenure and salary of judges were little, if at all, affected by the deep dip of the business cycle.

The work of public utility commissions is touching the public in more ways and in increasingly vital fashion as utility services are becoming more necessary in modern living. We shall need more not less regulation of utilities in the future, but it should be of a type that will encourage efficiency and discourage inefficiency and should be applied to all utilities regardless of the mode of ownership and operation. Easy gains through intercorporate relationships of private utilities and through government subventions of one sort or another for publicly owned utilities will relieve the management of either group of attaining the greatest possible efficiency in management. For example, it is not in the interest of the public for gas and electric utilities to be under a single management. These utility services compete with each other for many uses, and for a single management to allocate certain segments of the market to one or the other of these services relieves the management of the company from struggling to bring about greatest possible improvements in the case of each service. Only by such improvements are important advances in the arts likely to be stimulated. Moreover, if gas and electric utility properties are combined in arriving at a rate base and in calculating a fair return, it will relieve the one utility service that may be subsidized by the other in such a case from the necessity of bringing about advances in the arts or in extending the market for its service. By the same token, the management of a publicly owned and operated utility which is subsidized to a certain extent by public funds is relieved of much worry. It is very vital to all public utility consumers that the management of all utilities, regardless of their mode of ownership and operation, should not be relieved of their worries. Such anxieties on the part of the management will result in public benefit. In the early days of the gas industry in Massachusetts the gas companies volunteered to submit to regulation if the Commonwealth would protect them against the newer forms of gas-making and against electric light companies.[17] If we are to have intelligent and effective regulation of public utilities, we should place our public utility commissions on a basis

[17] "The Origin of Utility Commissions in Massachusetts," Leonard D. White, *Journal of Political Economy*, Vol. XXIX (March, 1921), p. 189.

that will compare favorably with the status of our courts. Both the public and the utilities are losers when a strong commission is crippled through lack of financial support. Where intelligent and effective administrative regulation is weakened, inefficient and even harmful political control is strengthened. Obviously the real responsibility rests upon the public itself to see that improvement is made in the character of commission regulation of such a nature that the Supreme Court will not feel the need of again taking over the functions of public utility regulation which in the Hope case it has indicated that the commissions should undertake.

It is a compliment to the Supreme Court that it has recognized after long and enlightening experience that members of the judiciary are not by training or by first-hand knowledge adequately fitted to deal with the complex economic and business issues that have arisen with the striking growth of utilities and the greater need for their regulation. The Court has been very frank in pointing out that utility commissions are in a more strategic position than is the judiciary to have the close contacts that are essential to an understanding of the need for making "pragmatic adjustments" in determining a rate base or in calculating, in a given case, what might constitute a fair rate of return. However, if the public itself does not recognize the need of improving the commissions, it is not probable that the Court will continue to support the position it has taken in the Hope case if it becomes convinced that the commissions are not measuring up to the responsibilities which that decision held they should assume. Even if, in theory, the commissions ought to be in a position to provide more effective public utility regulation than can be provided through the courts, the commissions are not likely to be permitted to exercise such control unless the public so improves their character as to enable these administrative agencies to justify the responsibilities which the recent action of the Supreme Court has placed upon them.

Flexible government control by commissions is not likely to be any more successful, indeed may be even more harmful, than was early rigid charter and statutory regulation unless it provides something more than mere flexibility. Intelligent and effective government control of utilities will require to an increasing degree high-grade utility commissions operating under such grants of authority as will give them both the opportunity and the re-

sponsibility to exercise control within such legislative standards as will enable them to make necessary "pragmatic adjustments" in specific cases. But these ends cannot be attained by commissions with inadequate funds and lack of competent personnel. In the last analysis, therefore, the public must determine whether future commissions are to be given such financial support as will enable them to attain through government control what could not be accomplished under early unintelligent and inflexible government regulation.